



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

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March 23, 2009

Mr. Paul Clanon, Executive Director
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Dear Mr. Clanon:

Final Report—California Public Utilities Commission, Internal Control Review of the Fiscal Office

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its internal control review of the California Public Utilities Commission's (Commission) Fiscal Office for the period ending December 24, 2008.

The enclosed report is for your information and use. The Commission's response to the report findings are incorporated into this final report. The Commission agreed with our observations and we appreciate its willingness to implement corrective actions. The observations in our report are intended to assist management in improving the effectiveness and efficiency of its operations.

In accordance with Finance's policy of increased transparency, this report will be placed on our website.

We appreciate the assistance and cooperation of the Commission. If you have any questions regarding this report, please contact Mary Kelly, Manager, or Angie Williams, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: Mr. Ed Quon, Deputy Executive Director, California Public Utilities Commission
Mr. Ravi Subramanian, Director, Information and Management Services Division,
California Public Utilities Commission
Mr. Frank Lindh, General Counsel, California Public Utilities Commission

AN INTERNAL CONTROL REVIEW

California Public Utilities Commission

Fiscal Office

Prepared By:
Office of State Audits and Evaluations
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Final reports are available on our website at <http://www.dof.ca.gov>

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EXECUTIVE SUMMARY

In accordance with an interagency agreement with the California Public Utilities Commission (Commission), the Department of Finance, Office of State Audits and Evaluations (Finance), performed a review of internal controls within the Commission's Fiscal Office. The objective of our review was to report on the sufficiency of internal controls and to identify control weaknesses and inefficient operations, policies, procedures, and systems. The review was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

In connection with our review, there are certain disclosures required by *Government Auditing Standards*. Finance is not independent of the reviewed entity, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

We examined the following activities of the Fiscal Office information technology, accounts payable, revolving fund, accounts receivable, cash receipts, and financial reporting. We determined that while many controls were effective and were functioning as intended, several material weaknesses were identified. When considered as a whole, these issues represent a high likelihood that a material misstatement will not be prevented or detected. The material weaknesses are identified in the *Results* section of this report.

The results of our review of the Fiscal Office system of internal control presents opportunities for management to correct identified weaknesses and improve its operations. We believe internal control would be strengthened and the Commission would operate more efficiently and effectively if management implements our recommendations. The internal control material weaknesses, if left uncorrected, increase the risk that material errors or irregularities could occur and remain undetected.

The issues in this report are based on fieldwork performed between June 24, 2008 and December 24, 2008. We presented our issues and observations to the related divisions, units, and management throughout our fieldwork.

This report is intended for the information and use of the Commission and is not intended to be and should not be used by anyone other than the specified parties. However, this restriction is not intended to limit the distribution of this report, which is a matter of public record.

BACKGROUND, OBJECTIVE, SCOPE, AND METHODOLOGY

Background

The California Public Utilities Commission (Commission) serves the public interest by protecting consumers and ensuring the provision of safe, reliable utility service and infrastructure at reasonable rates, with a commitment to environmental enhancement and a healthy California economy. The Commission regulates utility services, stimulates innovation, and promotes competitive markets, where possible, in the communication, energy, transportation, and water industries. The objectives of the Commission are carried out by over 970 employees. The Commission has an annual budget of \$1.2 billion in non-general fund monies.

The Commission contracted with the Department of Finance (Finance) to perform an internal control review of the Commission's Fiscal Office. The Fiscal Office has 19 employees who perform numerous functions, such as:

- Processing invoice payments
- Processing travel expense claims and salary advances
- Maintaining and controlling two office revolving funds
- Processing user fee and public program revenue collections
- Billing and processing transportation fund revenue
- Maintaining consumer impound accounts
- Collecting and recording fines receivable
- Billing and collecting reimbursement contract payments
- Preparing financial statements and maintaining the general ledger
- Remitting all revenue collected to the State Treasurer's Office
- Developing and processing all financial adjustments
- Assisting with special projects relating to fiscal matters
- Processing public program carrier claims
- Maintaining and updating California State Accounting and Reporting System (CALSTARS) and the California Automated Travel Expense Reimbursement System (CalATERS) tables
- Generating and distributing monthly and other requested CALSTARS reports
- Reconciling daily batches and correct error files

Objective and Scope

The objective of this review was to report on the sufficiency of internal controls within the Fiscal Office and identify control weaknesses and inefficient operations, policies, procedures, and systems. Specifically, Finance reviewed the areas of information technology, accounts payable, revolving fund, accounts receivable, cash receipts, and financial reporting. Certain Commission functions, such as budget operations and contracting, were not within the scope of this review and were not evaluated.

Methodology

To initiate this review, Finance gained an understanding of the Commission's mission and critical functions through review of documentation, interviews, surveys and workshops. Based upon this understanding, we developed a comprehensive risk assessment and a review strategy designed to identify risks. To confirm our understanding, we selected samples for substantive testing of transactions and account balances.

For our background review and preliminary risk assessment we reviewed: current policies and procedures, organization charts, prior audits, and the Commission's website.

We conducted individual interviews with executive management and Budget Control Officers from various divisions. These interviews were designed to gain an understanding of the Commission as a whole, and any risks that relate to the Fiscal Office. Also, we interviewed Fiscal Office staff to gather additional information on individual roles and responsibilities.

We prepared and administered an anonymous electronic survey to Fiscal Office employees to obtain their input on several key areas. The surveys included questions related to employee duties, information technology access controls, job satisfaction, communication, management effectiveness, and workload management. The surveys were administered to 18 employees in supervisory positions and below. Response rates ranged from 89 percent to 100 percent.

We conducted Control Self Assessment (CSA) workshops to identify policies, processes, and potential risks. These facilitated group workshops identified and documented key activities, risks to the areas under review, and provided staff feedback on review recommendations.

Issues and recommendations were developed based on our review. Material weaknesses are presented in the *Results* section of this report, while immaterial issues were discussed with Fiscal Office representatives. This review was conducted during the period June 2008 through December 2008.

The California Public Utilities Commission's (Commission) management is responsible for establishing and maintaining an effective system of internal control, including documenting the system, communicating the system requirements to employees, assuring that the system is functioning as designed, and modifying the system as changes in conditions warrant.

During our internal control review of the Commission's Fiscal Office, we noted many effective controls. However, we identified areas where controls are either not in place or not functioning as intended, and where corrective action is necessary. There exist several material weaknesses that when considered as a whole, represent a high likelihood that a material misstatement will not be prevented or detected.

ISSUE 1 Weaknesses Identified In Control Environment

Condition: The control environment is the foundation for all other components of internal control. It can be defined by the "tone at the top," and influences how management incorporates risk-awareness and control activities into the daily work routines. We identified the following weaknesses in the Commission's control environment.

1. 47 percent of Fiscal Office staff surveyed indicated that their supervisor or manager does not follow the policies it has established.
2. Interviews with staff disclosed instances where management overrode the Commission's policy regarding vendor payments. Although a vendor completed Standard Form 204 is required to issue vendor payments, management directed staff to process vendor payments using only the Taxpayer Identification Number, and without the completed Standard Form 204. This practice is in violation of the State Administrative Manual (SAM) and results in increased workload for the Fiscal Office.
3. The Fiscal Office has a written policy of issuing revolving fund checks on Friday, but management often overrides this policy. In October and November 2008, 347 of 603, or 58 percent of revolving fund checks were issued on days other than Friday. This practice increases the Fiscal Office workload and reduces operating efficiency.

Criteria: SAM Section 20050 states, the ultimate responsibility for good internal control rests with management. The foundation of all internal control components is the Control Environment.

SAM Section 8112.3 "Vendor Identification Data" states, Standard Form 204 must be completed by the vendor and will provide, among other data, the vendor's tax identification number. The form is to be retained on file at the State agency.

Commission policy, effective June 9, 2008 titled "Manual Travel Claim and Miscellaneous Revolving Fund Requests Processing Changes" states, beginning June 13, 2008, "Miscellaneous revolving fund requests need to be submitted to the Fiscal Office by Wednesdays at 12 p.m." and "Checks will be issued every Friday."

Recommendations: Management should implement and enforce the current written policies and procedures over the revolving fund.

Management should review the instances of override of controls, ensure that mitigating controls are in place and discuss with appropriate staff to determine whether training is required.

ISSUE 2 Lack of Established Policies and Procedures

Condition: The Fiscal Office does not maintain adequate written policies and procedures for many of its essential business functions. Specifically, 65 percent of the staff responding to our survey indicated the Commission lacks adequate documentation of policies and procedures. For instance, we verified there are no written procedures for the following processes:

- Depositing checks
- Remittances to the State Treasurer's Office
- Legal Division notification to the Fiscal Office of any possible contingent liabilities needing to be recorded
- Discharging of uncollectible amounts
- Reviewing of aged receivables

Lack of well documented procedures can create key person dependency, fraud or errors, inefficiencies, and inaccuracies.

Criteria: Government Code (GC) Section 13403 states, the elements of a satisfactory system of internal accounting and administrative controls, shall include, but are not limited to:

1. A system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures.
2. An established system of practices to be followed in performance of duties and functions in each of the state agencies.

Recommendations: The Fiscal Office should document key processes and procedures and disseminate the information throughout the Commission. Any new procedures or modifications of existing procedures should be developed in

coordination with other divisions. In addition, the Fiscal Office should consult with other divisions to ensure documented policies and procedures conform to any future requirements in format and content.

ISSUE 3

Inadequate Controls Over Transactions

Condition: Inadequate controls over transactions were identified in the accounts receivable, travel advances, salary advances, and cash receipts processes.

Accounts Receivable

The Commission's accounts receivable amount is not accurately reported. The Utility Safety and Reliability Branch creates a propane user fee bill, but no accounts receivable is established. The bills are forwarded to the Fiscal Office only when the payment has been received by the Utility Safety and Reliability Branch. This practice does not allow the Fiscal Office to timely and properly record an account receivable in the accounting records. In addition, because the Fiscal Office does not receive notice of the bill and payments are received in another division, this increases the risk of fraud and theft by Commission employees.

The Commission is not monitoring their aged receivables. We identified \$34,522,381 in outstanding (over 120 days) receivables as of October 2008. As receivables age the likelihood of collection decreases. Failure to monitor aging receivables can result in decreased revenue, and material misstatements on the Commission's financial statements.

Failure to appropriately monitor, collect and adjust accounts receivable increases the risk of fraud, inaccurate financial statements, and lost interest for the Commission.

Travel Advances

The Fiscal Office does not maintain supporting documentation for travel advances and no collection efforts have been made on outstanding advances. We identified 110 out of 116 (95 percent) outstanding travel advances that did not have adequate supporting documentation. Furthermore, 90 of 116 (78 percent) travel advances have been outstanding for more than 120 days.

Salary Advances

The Fiscal Office does not maintain supporting documentation for salary advances and no collection efforts have been made on outstanding advances. We identified 101 out of 106 (95 percent) outstanding salary advances that did not have adequate supporting documentation. Furthermore, 92 of 101 (91 percent) salary advances have been outstanding for more than 120 days.

The lack of documentation, monitoring and collection effort greatly reduces the likelihood that advanced funds will be recovered. In addition, the lack of controls increases the risk of fraudulent claims.

Cash Receipts

Deposits are not always remitted timely. We reviewed five funds during the period of September 2, 2008 through September 24, 2008 to determine interest lost as a result of untimely remittances. The amounts below represent the amount of interest lost in each fund for the month of September, totaling \$1,870,224:

Fund 0493:	\$ 92,521
Fund 0483:	\$ 209,066
Fund 0471:	\$1,198,937
Fund 0470:	\$ 234,810
Fund 0464:	\$ 134,890

- Criteria: SAM Section 8776 states that an accounts receivable is defined as a claim against a person, firm, corporation, or other entity for money owed to the state.
- SAM Section 8034.1 states that agencies will endorse checks, warrants, money orders, and other negotiable instruments on the day they are received.
- SAM Section 8776.6 states if all collection procedures do not result in payment, departments may request discharge from accountability of uncollectible amounts due from private entities. Departments will review their accounts receivable no less than quarterly to identify receivables for discharge.
- SAM Section 8116.3 states if an employee does not submit a travel expense claim to substantiate the travel expenses within 30 calendar days of the periodic statement date, the total travel advance amount must be deducted from the next regular payroll warrant(s).
- SAM Section 8595 states that agencies shall pay the difference between the employee's full net pay and the salary advance upon receipt of the Controller's warrant for the full salary payment.
- SAM Section 8091 states that accumulated deposits of \$25,000 will be remitted as soon as possible, but not later than the first day of the week following the collection.
- Recommendations: Inadequate controls over transactions were identified in the accounts receivable, travel advance, salary advance, and cash receipts processes. Specifically, the Fiscal Office should work with the Utility Safety and Reliability Branch to develop and implement procedures to improve the timely recording of receivables. Also, the Commission should take steps to ensure payments are endorsed and then forwarded to the Fiscal Office immediately.
- The Commission should more closely monitor outstanding receivables.

All appropriate efforts to collect outstanding receivables should be promptly undertaken and well documented. Finally, if collection efforts are unlikely to result in additional money collected, the Commission should request discharge from accountability.

The Commission should work with employees to immediately resolve all outstanding advances. The Fiscal Office should draft guidance to establish supporting documentation and monitoring requirements.

Policies and procedures should be developed and enforced to ensure timely remittance as required by SAM.

ISSUE 4

Inadequate Controls over Information Technology

Condition:

The Commission does not maintain adequate controls over access to critical information. Specific weaknesses identified include:

- Eight employees retained CALSTARS access after separation from state service.
- Eleven employees were granted CALSTARS access that was incompatible with one or more modules within CALSTARS.
- Changes in duty status are not automatically reviewed for conflicts with information system access rights.
- The Commission does not maintain a comprehensive listing of user access permissions.
- Separating employees are not automatically removed from network access on their last day of employment.

Ineffective access controls may allow unauthorized users to access critical information systems to intentionally manipulate, destroy, or acquire Commission data.

In addition to not maintaining adequate control over critical information, the Commission lacks a comprehensive inventory and classification of data stored within its information systems and databases. Failure to classify information increases the risk of unauthorized access, use, disclosure, modification, or destruction of public records. Such incidents would likely result in significant financial and legal penalties against the Commission. In addition, failing to protect confidential information could result in significant damage to the Commission's image.

Criteria:

GC Section 13403 states the elements of a satisfactory system of internal accounting and administrative controls shall include a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets.

SAM Section 5320.5 requires agencies to classify each file and database as either public or confidential information.

Recommendations: The Commission should develop role based access control protocols for all employees, such as that promulgated by the National Institute of Standards and Technology (NIST). In addition, the Commission should develop a plan to ensure employees that transfer from the Commission or separate from state service have all access rights terminated on their final day of work. Finally, the Commission may seek the assistance of the Office of Information Security and Privacy Protection in developing new access controls.

The Commission has recognized the deficiencies in its data inventory and classification. The Commission staff report that the Commission's Chief Information Officer (CIO) has a plan to reduce this risk to an acceptable level. However, the following immediate measures should be taken to mitigate risks to the most sensitive and vulnerable data:

- The CIO should issue immediate guidance to Division Directors on data inventory, classification and protection requirements.
- The CIO should work with management to improve data management. Communication and potential collaboration opportunities may lead to improved outcomes, expanded functionality, and reduced costs.

ISSUE 5 Inadequate Controls Over Financial Reporting

Condition: There was no review performed on the monthly reconciliations for Funds 0042, 0046, 0462, 0464, 0470, 3015, and 3089 for the months of July 2008 through November 2008. Also, the quarterly trial balance and quarterly statement of revenue were not being prepared by the Fiscal Office staff.

These controls help ensure errors and omissions are detected and corrected timely and ensures the integrity of financial reporting.

Criteria: SAM Sections 7908 and 7940 states all reconciliations will show the preparer's name, reviewer's name, date prepared, and date reviewed. Also, quarterly reports must be prepared timely.

Recommendations: The Fiscal Office should designate staff with sufficient authority and training to review reconciliations. Once all reconciling items are cleared the reviewer should annotate their name and date near the preparer's name and date. In addition, prepare the trial balance and statement of revenue report quarterly as required by SAM.

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



PAUL CLANON, EXECUTIVE DIRECTOR

February 11, 2009

Mr. David Botelho
Chief, Office of State Audits and Evaluations
915 L Street
Sacramento, CA 95814-3706

**RE: OSAE Report – California Public Utilities Commission, Internal Control
Review of the Fiscal Office**

Dear Mr. Botelho:

Thank you for the January 15, 2009 draft report titled California Public Utilities Commission, "An Internal Control Review, Fiscal Office." Thank you also for the opportunity to respond to the report.

While the California Public Utilities Commission (Commission) is proud of the improvements made in the Fiscal Services Office and the Information Technology and Management Services Division (IMSD), the Commission greatly values periodic assessments by control agencies. Early in 2008, the Commission invited the Office of State Audits and Evaluations (OSAE) to conduct an audit of the Commission's internal control policies and procedures.

This report, a result of the work conducted by the OSAE team, highlights areas that can be further improved and provides valuable feedback. The Commission intends to implement the recommendations and the suggested improvements.

Please contact Ravi Subramanian, IMSD Director, at (415) 703-2163 if you have any further questions.

Sincerely,

Original signed by:

PAUL CLANON
Executive Director

Attachment
Commission response to OSAE's Internal Control Review of the Fiscal Office

OSAE RECOMMENDATION AND CALIFORNIA PUBLIC UTILITIES COMMISSION RESPONSE

ISSUE 1: WEAKNESSES IDENTIFIED IN CONTROL ENVIRONMENT

OSAE Recommendation

Management should implement and enforce the current written policies and procedures over the revolving fund.

Management should review the instances of override of controls, ensure that mitigating controls are in place and discuss with appropriate staff to determine whether training is required.

Commission Response

The Commission will immediately evaluate its revolving fund processes and initiate regular reviews to ensure policies and procedures adhere to the State Administrative Manual. The Commission agrees that management should align with the written policies and procedures over revolving fund to better safeguard its assets. The Commission agrees that a Standard form 204 must be duly executed prior to processing payment and Fiscal staff will ensure that the form 204 will be in place before payment is rendered.

ISSUE 2: LACK OF ESTABLISHED POLICIES AND PROCEDURES

OSAE Recommendation

The Fiscal Office should document key processes and procedures and disseminate the information throughout the Commission. Any new procedures or modifications of existing procedures should be developed in coordination with other divisions. In addition, the Fiscal Office should consult with other divisions to ensure documented policies and procedures conform to any future requirements in format and content.

Commission Response

The Commission concurs with OSAE that policies and procedures should be documented and disseminated throughout the Commission. The Commission has begun documenting certain key processes and procedures: Depositing checks, Remittances to the State Treasurer's Office, Legal Division notification of possible contingent liabilities that need to be recorded, Discharging of uncollectible amounts, and Reviewing of aged receivables to comply with Government Code (GC) Section 13403. Over the next months, the Commission will develop and document other key processes and procedures.

Each Division's Budget Control Officer (BCO) acts as a liaison for all budget and fiscal related issues. Through the BCOs, the Commission will also communicate the processes and procedures to all Divisions. The Commission will actively consult with all the divisions to ensure conformance and compliance with the policies and procedures. The Fiscal Office has already begun work in some areas. For example, the Fiscal Office will submit monthly reports to the Division's BCOs informing the respective Divisions of employees who have outstanding documentation related to salary and travel advances. The Fiscal Office will work with the Legal and Human Resources Divisions to clarify procedures for the inclusion of contingent liabilities in the Fiscal Office accounting system and will subsequently monitor adherence to the procedures. The Commission is actively recruiting to hire staff to review and collect aged receivables in a timely manner.

ISSUE 3: INADEQUATE CONTROLS OVER TRANSACTIONS

OSAE Recommendation

Inadequate controls over transactions were identified in the accounts receivable. Travel advance, salary advance, and cash receipts processes. Specifically, the Fiscal Office should work with the Utility Safety and Reliability Branch to develop and implement procedures to improve the timely recording of receivables. Also, the Commission should take steps to ensure payments are endorsed and then forwarded to the Fiscal Office immediately.

The Commission should more closely monitor outstanding receivables. All appropriate efforts to collect outstanding receivable should be promptly undertaken and well documented. Finally, if collection efforts are unlikely to result in additional money collected, the Commission should request discharge from accountability.

The Commission should work with employees to immediately resolve all outstanding advances. The Fiscal Office should draft guidance to establish supporting documentation and monitoring requirements.

Policies and procedures should be developed and enforced to ensure timely remittance as required by SAM.

Commission Response

The Commission concurs with OSAE and will review and establish controls over accounts receivable transactions. The Commission will actively monitor and collect outstanding receivables. It will develop guidelines and training for Fiscal Office and other Commission staff on SAM guidelines, particularly on Salary and Travel Advances and work with Human Resources to enforce payroll deductions on outstanding advances.

ISSUE 4: INADEQUATE CONTROLS OVER INFORMATION TECHNOLOGY

OSAE Recommendation

The Commission should develop role based access control protocols for all employees, such as the promulgated by the National Institute of Standards and Technology (NIST). In addition, the Commission should develop a plan to ensure employees that transfer from the Commission or separate from state service have all access rights terminated on their final day of work. Finally, the Commission may seek the assistance of the Office of Information Security and Privacy Protection in developing new access controls.

The Commission has recognized the deficiencies in its data inventory and classification. The Commission staff report that the Commission's Chief Information Office (CIO) has a plan to reduce this risk to an acceptable level. However, the following immediate measures should be taken to mitigate risks to the most sensitive and vulnerable data:

- The CIO should issue immediate guidance to Division Directors on data inventory, classification and protection requirements.*
- The CIO should work with management to improve data management. Communication and potential collaboration opportunities may lead to improved outcomes, expanded functionality, and reduced costs.*

Commission Response

Over the next few months the Commission plans to conduct a security audit and develop access control protocols for all employees. IMSD is developing entry and exit policies and procedures to ensure the safety and protection of the Commission's resources. IMSD will work with the Human Resources and other divisions to implement those policies and procedures.

The Commission's Chief Information Office (CIO) has started development of a plan to reduce the risk associated with data inventories and classification. The CIO will begin working with Division Directors on data inventory, classification and protection requirements, and seek out collaboration opportunities.

ISSUE 5: INADEQUATE CONTROLS OVER FINANCIAL REPORTING

OSAE Recommendation

The Fiscal Office should designate staff with sufficient authority and training to review reconciliations. Once all reconciling items are cleared the reviewer should annotate their name and date near the preparer's name and date. In addition, prepare the trial balance and statement of revenue report quarterly as required by SAM.

Commission Response

The Commission agrees that reconciliation should be performed monthly and will institute mechanisms for a monthly reconciliation of funds. The Commission must note that OSAE's discovery period coincided with the year end closing, therefore closing of the fund records took priority over reconciliation. Furthermore, the delay in adoption of the fiscal year 2008-2009 budget until October resulted in delays of the reopening of the records.